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IN THE

Supreme Court of the United States

OCTOBER TERM, 1935.

No. 346.

MATSON NAVIGATION COMPANY (a corporation), THE OCEANIC STEAMSHIP COMPANY (a corporation), and MATSON TERMINALS, INC. (a corporation), *Appellants*,

v.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA, JOHN C. CORBETT, FRED E. STEWART, R. E. COLLINS, H. G. CATTELL and RAY L. RILEY, the Members of Said State Board of Equalization, and CHARLES J. McCOLGAN, Franchise Tax Commissioner of the State of California, *Appellees*.

REPLY TO BRIEF OF APPELLEES.

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TABLE OF CONTENTS.

	Page
I. THE NATURE OF THE TAX	1
The taxation of corporations prior to 1928 and the change in the character of corporate taxation proposed at that time	2
II. THE SUBJECT OF THE TAX	14
III. THE MEASURE OF THE TAX	19
IV. DENIAL OF EQUAL PROTECTION OF LAWS	20
V. DUE PROCESS	22

TABLE OF CASES.

Alpha Portland Cement Co. v. Massachusetts, 268 U. S. 203 13
Anglo-Chilean Nitrate Sales Corporation v. Alabama, 288 U. S. 218 15
Cudahy Packing Company v. Minnesota, 246 U. S. 450. 12
Detroit International Bridge Co. v. Tax Appeal Board, 287 U. S. 295 ..... 15, 18
Matson Navigation Co. v. State Board, 43 Pac. (2nd) 805-810 11
Miller and Lux, Inc. v. Richardson, 182 Cal. 115..... 4
New Jersey Bell Telephone Co. v. State Board of Taxes, 280 U. S. 338 ..... 13, 15
Pacific Company, Ltd. v. Johnson, 285 U. S. 480..... 10, 16
Pacific Express Co. v. Siebert, 142 U. S. 339..... 17
Pullman Company v. Richardson, 261 U. S. 330..... 2, 12
Royster Guano Co. v. Royster, 253 U. S. 412..... 21
Schwab against Richardson, 263 U. S. 88, 188 Cal. 27.. 13
The Pacific Company, Ltd. v. Johnson, 212 Cal. 148..10, 11
Underwood Typewriter Co. v. Chamberlain, 254 U. S. 113 19
Union Oil Association v. Johnson, 2 Cal. (2nd), 727, 734 ..... 11, 14
Union Tank Line Co. v. Wright, 249 U. S. 275, 283.. 12
United States Glue Co. v. Oak Creek, 247 U. S. 321.... 19

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REPLY TO BRIEF OF APPELLEES.

I.

THE NATURE OF THE TAX.

(Brief of Appellees, pp. 1-13)

The brief for appellees suggests a novel contention with respect to the nature of the tax in dispute. Without explicit statement, it suggests that the tax has some analogy to a tax on property. We say that this suggestion is novel

because it flies in the face of the statutory language, of the decision of the State Supreme Court and of the actual incidence and operation of the tax. The suggestion is as false as it is novel. To show its groundlessness, a brief reference to the history of corporate taxation in California will be helpful.

The Taxation of Corporations prior to 1928 and the Change in the Character of Corporate Taxation Proposed at that Time.

Prior to 1910 all corporate property, tangible and intangible, was assessed by the local taxing authorities for both State and local purposes. In November, 1910, an amendment to the State Constitution (often referred to as Amendment Number One) was adopted as Section 14 of Article XIII. Under this Amendment the operative property of public utilities was withdrawn from local taxation and State taxes were imposed on the utilities, measured by varying proportions of their gross receipts. It was this tax upon public utilities which came before this Court in *Pullman Company* v. *Richardson,* 261 U. S. 330, where the tax was said to be a tax according to the value of the property. In that case this Court said:

> "The provisions under which the tax is imposed call it a property tax, specify the property subjected to it, and declare that it is in lieu of all other taxes on such property. The Supreme Court of the State holds it is a tax on the property specified."

The Amendment of 1910 also imposed a tax of 1.5 per cent on the gross premiums of insurance companies, but such companies were to continue to pay their local taxes on real estate and could use such real estate taxes to offset the State taxes. The Amendment also imposed a tax on the shares of capital stock of banks. Finally, the Amendment imposed a one per cent tax on the "franchises" of all corporations other than public utility corporations, banks and insurance

companies. This latter provision was embodied in Section 14 (d), Article XIII, reading as follows:

> "All franchises other than those expressly provided for in this Section, shall be assessed at their cash value, in the manner to be provided by law, and shall be taxed at the rate of one per centum each year, and the taxes collected thereon shall be exclusively for the benefit of the State."

In 1927 a crisis arose as the result of claims made and fears entertained that the tax on national banks, imposed by Section 14, Article XIII, was invalid because of its failure to comply with Section 5219 of the Revised Statutes of the United States. In this emergency the Legislature of the State provided for the appointment of the California Tax Commission. This Commission, by its report of August 10, 1928, recommended that the Constitution be amended to provide for a tax on banks, including national banks, "according to or measured by their net income," as permitted by the amended provisions of Section 5219 of the Revised Statutes; and to provide that other non-utility corporations should pay "for the privilege of exercising other corporate franchises within this State, a tax according to or measured by their net income." The bank tax and the general corporate tax were to be measured by the same rate of four per cent of the net income. In this way the State might be enabled to comply with the requirements of Section 5219 that the rate of tax upon national banking associations "shall not be higher than the rate assessed upon other financial corporations nor higher than the highest of the rates assessed by the taxing State upon mercantile, manufacturing and business corporations doing business within its limits." It was also recommended that provision be made for the taxation of intangible property.

Pursuant to these recommendations the legislative proposed, and the people of the State adopted on November 6, 1928, the Amendment adding Section 16 of Article XIII

of the Constitution. This Amendment is set forth at length on pages 1-3 of the appendix to our brief.

The report of the California Tax Commission of August 10, 1928, sets out clearly and definitely the nature of the old tax assessed against corporations under Article XIII, Section 14 (d), and the radically different nature of the new tax proposed to be assessed. In this respect the Tax Commission said:

> "The present franchise tax is a misnomer. It is really a 'corporate excess' tax (Miller and Lux, Inc. v. Richardson, 182 Cal. 115). It was established in its present form, except as to rate, in 1910, through the passage of Amendment Number One."
>
> *Final Report of the California Tax Commission—Submitted March 5, 1929, p. 265.*

The accuracy of the Commission's statement is fully established by the case cited, *Miller and Lux, Inc.* v. *Richardson,* 182 Cal. 115. That case held that the 1910 Amendment did nothing more than transfer to the State authorities the power, theretofore exercised by local authorities, to levy a property tax upon the whole corporate excess. The method of assessment ordinarily employed was to ascertain the value of the excess by deducting the assessed value of the corporate tangible property from the value of all outstanding corporate securities.

The Tax Commission found that the results obtained from this property taxation had been unsatisfactory. In this respect, the Commission said:

> "It is clear, then, that the practice of taxing corporate excess under the title of a franchise tax is one of long standing in California. The numerous complaints which this Commission has received indicate, however, that the hope of the 1910 Commission that the transfer of the administration of this tax from the local assessors to the State Board of Equalization would result in 'certainty and uniformity,' has not been completely fulfilled. The evidence before the Commission indi-

cates that, from the point of view of the taxpayer, the present franchise tax is an arbitrary tax, the amount of which it is impossible to anticipate and accrue. The taxpayers complain that they are unable to secure any explanation as to the basis on which the assessments are made, although it is generally understood that the underlying procedure is primarily that of the old corporate-excess method. Gauged as a device in a general property tax system designed to supplement local assessments of tangible property, the present franchise tax appears to be open to criticism, both because, if it succeeds in attaining its object, it is unjust, and because it does not succeed in attaining its object.

The trend in modern tax reform is distinctly away from the theory of the general property tax. Tangible property, or at least land and buildings, will doubtless continue to be taxed where located and without deduction for debts. In addition to such property taxation, there is rapidly being developed a system of business taxes imposed where the business activity is carried on, and measured by the earnings of the business or by some approximation thereto. In connection with its statistical study, the results of which are set forth later in this report, the Commission's technical staff has subjected the present franchise tax to an exhaustive test with respect to its inadequacy as a modern business tax, and measured by this test, as will be seen from the figures there presented, it is without merit."

Final Report of California Tax Commission, submitted March 5, 1929, pages 266-267.

The report of the Commission shows, beyond any possibility of doubt, that it realized that its proposal involved a complete departure from the old theory of property taxes and the substitution of a new theory of business taxation, as far as banks and business corporations were concerned. After the adoption of the Constitutional Amendment of 1928, the Commission, in its final report, said:

"In August of 1928, this Commission made a special report recommending that banks and ordinary business corporations be subjected to a new franchise tax, to be 'measured by or according to net income' at the rate

of 4 per cent. This tax was to be in substitution for the then existing taxes on bank shares and on the franchises of business corporations. This recommendation, which was adopted by the legislature in September and by the people in November, was prompted by the apparent illegality of the bank share tax. The details of this change are discussed elsewhere. The action taken may prove to be of great significance, however, as the first departure from the general theory of Amendment Number One that property should be the fundamental test of the adequacy of all business taxation in California."

Final Report of the California Tax Commission, submitted March 5, 1929, page 41.

Again, discussing more comprehensively the theory of State taxation, the Commission, in its final report, said:

"The adoption of Amendment Number One, in 1910, was clearly a recognition of the complete failure of the old general property tax and an effort to establish in its place an objective property tax. The gross receipts taxes on utilities and the special taxes on banks, insurance companies and corporate franchises were justified as covenient and approximately accurate methods of reaching the property values of the corporations of these different types. The Commission found the 1910 plan, so far as it applied to banks, to be wrecked on legal rocks. It found the 1910 plan, so far as it applied to the franchises of ordinary business corporations, to be discredited. It found the 1910 plan, so far as it applied to public utilities, to be so faulty as to render its continuance undesirable. It found the 1910 plan, so far as it applied to personal property, to be a farce. It found that the 1910 plan made real estate the residuary legatee of the troubles generated by the failure of the other portions of the system.

Forced to consider the bank tax problem as an emergency of pressing importance, it recommended in a special report that the bank-share tax which had been established in 1910 be abolished and that instead the banks be subjected to a business tax 'measured by or according to' their net income. This action involved substituting a similar tax upon business corporations

generally in place of the old 1910 franchise tax. It recommended also that foreign securities and solvent credits be taxed at a low flat rate. It defended these recommendations not only on the ground that the changes were necessary to meet an emergency, but also on the ground that they would harmonize with the general plan for recasting the tax system of the state which the Commission would later submit.

What should this new general plan be? Should an effort be made to turn back the hands of the clock and revert to the old general property tax which had been abandoned as obsolete two decades ago? Nothing in the experience of other states indicates that there is any hope of salvation in such a course. On the contrary, development elsewhere is distinctly away from the deceptively simple property tax as an ideal of state taxation and toward a more diversified plan.

This plan, the Commission believes, should ultimately consist of three distinct but complementary elements: First, a property tax of reduced scope; second, a business tax upon all business activities carried on within the borders of the state; and, third, a personal tax levied upon all residents of the state.

The acceptance of such a plan involves the abandonment of the traditional assumption which nominally underlies the tax system at the present time, namely, that the sole test of equity in taxation is property values. It involves the abandonment of the attempt to use the property tax for purposes to which it is not well adapted."

Final Report of the California Tax Commission, submitted March 5, 1929, pages 74-75.

After referring to a proposal to return the real estate of the public utilities of the counties for inclusion in the local tax base, the Commission recurs to the fundamental theory of business taxes, as contrasted with property taxes, in the following language of its report:

"One of the three major elements of the proposed new tax system for California consists of a series of taxes on business. At the present time California has a number of levies which are essentially business taxes,

but they are camouflaged as property taxes or taxes in lieu of property taxes. It is proposed to recognize these levies as true business taxes, refine them and relate them systematically to each other. It is hoped that when this reorganization is complete, the business men of California can rest assured that the tax system imposes no discriminations as among businesses and inflicts no significant competitive disadvantage upon any one class of business endeavor. It is hoped that the reorganized system will enable the people of the state to make clear-cut and intelligent decisions as to the extent they desire to impose taxes upon business as such, as contrasted with persons and property.

The case in favor of business taxation has been well stated by Professor T. S. Adams in the following paragraphs:

> The strongest reason for the retention and perfection of business taxation is found in experience and fiscal history. Business taxes are as old as business history. They are all but universal throughout the world and show no tendency to disappear with the passage of time. * * *
>
> From political and moral standpoints, the justification of this great class of taxes is plain. A large part of the cost of government is traceable to the necessity of maintaining a suitable business environment. * * * The industry which does not pay its due share of public expense is generally a source of weakness and not a source of strength.
>
> Finally, taxes on business have great fiscal virtue as such. They are relatively inexpensive to collect and comparatively productive in yield.
>
> ('The Taxation of Business,' Proceedings, National Tax Association, 1917, pages 186-187.)

With respect to the base which should be used in measuring liability for business taxes, the same authority says:

> There is no perfect measure of any tax. Net income is not a perfect measure. But it is a better measure than gross income. * * * I have had some experience with a highly classified business tax. I have

no hesitation in stating that the legislative task of differentiating the rates, together with the subsequent administrative task of locating each industry in its proper place, raises more and more difficult problems than are raised by the net income tax. In the long run the net income tax is the simpler; it wears better.

Moreover, classified business taxes almost always look up to the net income tax as their final goal and approach it more closely year by year. (Ibid., page 190.)

Final Report of the California Tax Commission, March 5, 1929, p. 76.

The Commission then points out that the taxes upon banks and corporations, which were provided for by the Amendment of November 1928, were based on this theory of substituting business taxes for property taxes. In this respect the Commission says:

"The recommendations of this Commission in its special report of August 10, 1928, which bore fruit in the constitutional amendment adopted in November, 1928, were defended before the legislature and before the people not merely on the ground that the suggested course of action represented the only available solution under the circumstances, but also on the ground that they would establish a modern and desirable method of taxing corporations."

Final Report of the California Tax Commission, Submitted March 5, 1929, p. 76.

Then, after quoting the language of Section 16 of Article XIII as adopted November 6, 1928, the Commission summarizes the change made as follows:

"At this point comment will be restricted to the provision for taxes on banks and corporations. The sections dealing with foreign securities and solvent credits will receive attention in another section. In general the new tax on banks and corporations is a charge imposed upon the privilege of doing business in Califor-

nia, the measure of the value of the privilege being the record of earnings established during the previous year. In the opinion of the Commission this measure furnishes the foundation for a comprehensive and equitable system of business taxes in the state. This portion of the structure of the proposed new tax system can be accepted as being well along toward completion."

Final Report of the California Tax Commission, March 5, 1929, p. 78.

See also the historical statement in

The Pacific Company, Ltd. v. *Johnson*, 212 Cal. 148.
Pacific Company, Ltd. v. *Johnson*, 285 U. S. 480.

The Nature of the Tax as Shown by the Language of the Constitution and the Statute.

Neither the Constitution nor the statute contains the slightest indication that the tax under discussion is a property tax, or is in the nature of a property tax, or is intended to be measured by property values. On the contrary, the Constitution declares that the corporations involved shall pay "for the privilege of exercising their corporate franchises within this State a tax according to or measured by their net income."

Constitution of California, Article XIII, Section 16, Subdivision 2 (*a*), Appendix to Brief for Appellants, page 2.

Likewise the statute declares that each corporation involved "shall annually pay to the State, for the privilege of exercising its corporate franchise within this State, a tax according to or measured by its net income."

The California Banking Corporation Franchise Tax Act, Sec. 4, Statutes of California, 1929, page 19, Appendix to Brief for Appellants, page 5.

Language could not be more explicit to negative any intention to tax property or property value. On the face of the statute the tax is an excise and nothing more.

The Nature of the Tax as Shown by the Decisions of the State Supreme Court.

Every decision of the Supreme Court of California which has involved the tax is to the effect that it is not a property tax, or one measured by the value of property, but that it is on the contrary an excise tax on business.

Such is the necessary effect of the *Pacific Company, Ltd.* v. *Johnson,* 212 Cal. 148, which held that income from tax exempt bonds might be included in the measure of the tax. If the tax had been a property tax, it could not have been applied to the bonds in question. But the Supreme Court of the State said in so many words: "The tax is not a property tax."

The Pacific Co., Ltd. v. *Johnson,* 212 Cal. 148, 158.

It likewise appears from *Union Oil Associates* v. *Johnson,* 2 Cal. (2nd) 727, that the State Supreme Court considers the tax to be an excise tax and not a property tax or in the nature of a property tax. In that case the tax on banks, expressed in identical statutory language, was specifically described as a "state excise tax."

Union Oil Associates v. *Johnson,* 2 Cal. (2nd), 727, 734.

And in the present case the opinion of the State Supreme Court does not contain the slightest suggestion or hint that the tax is one on property or according to the value of property. To the contrary, the Court says:

> "We emphasize the fact that the act here involved imposes a tax on a corporation 'for the privilege of exercising its corporate franchise within this state'."

Matson Navigation Co. v. *State Board,* 43 Pac. (2nd), 805, 810.

The cases relied upon by Appellees do not apply.

We have here a situation where the state formerly imposed a property tax on the corporate excess, and where (at least as to the class of corporations here involved) it consciously abolished and rejected this property tax on the corporate excess and provided instead for (1) a continuance of the ordinary property taxes on the tangible property of the corporation and (2) an excise tax on the doing of business by the corporation, measured by net income.

To such a situation the cases cited on page 10 of the brief of appellees can have no possible application. Extended analysis of these cases would be superfluous. It will suffice to refer to the two most recent, *Pullman Company* v. *Richardson,* 261 U. S. 330, and *Cudahy Packing Company* v. *Minnesota,* 246 U. S. 450. Under these cases if a tax on a utility is declared to be a property tax by Legislature and Courts, if it is intended to be measured by the actual value of the property, although otherwise then by direct assessment, if its rate is not higher than the rate of taxation on other property and if, finally, it is imposed in lieu of all other taxes, then if may, under these decisions, be considered as being substantially a property tax. But in order that this rule should apply, it must appear that the method used is such as to result in the ascertainment of the real value with at least approximate accuracy. *Union Tank Line Co.* v. *Wright,* 249 U. S. 275, 283. These conditions must concur in order that the tax be treated as a property tax. It is obvious that none of them exist in the present case, and we submit that the argument of appellees on this point is without foundation. There is no warrant for the suggestion, implied in their brief, that a tax which burdens interstate commerce in its actual operation is rendered innocuous because of the mere fact that it was imposed "in lieu of" another wholly different kind of tax which was valid.

A tax imposed, not in lieu of all property taxes, but in lieu of all other franchise taxes, is not to be deemed a property tax where it does appear that the tax is measured by the value of property.

New Jersey Bell Telephone Co. v. *State Board of Taxes*, 280 U. S. 338.

A determination of real value with fair accuracy is essential, in order that the tax may be considered as in the nature of a property tax.

Alpha Portland Cement Co. v. *Massachusetts*, 268 U. S. 203.

Schwab against Richardson, 263 U. S. 88, 188 Cal. 27, is not in point for many reasons. In the first place it was a tax on the property value of the corporate excess and the right to be, under the old system of corporate taxation. The accuracy of the valuation of the property was admitted by the pleadings. Obviously, the tax was thereby shown to be good. The case has no application to an excise tax on the doing of business or on the right to do business.

When appellees state (at page 5 of their brief) that the new tax "was in lieu of property taxes upon the corporation subject hereto" they are merely stating their contention that the present excise tax on business took the place of the old property tax on the corporate excess. The direct property taxes on the tangible property of non-utility corporations have always remained in force and the new taxes are not "in lieu" thereof.

Section 1 of Article XIII of the Constitution of California, quoted at pages 7-8 of appellees brief is, of course, subject to the effect of later amendments on the subject of taxation, and is subject, particularly, as far as the taxation of these appellants is concerned, to the later and controlling provisions of Subdivision 2 (a) of Article XIII, Section 16.

Section 3664 (d) of the Political Code of California, quoted at pages 8-9 of the brief of appellees, refers to the old system of property valuation of the corporate excess, and not at all to the substituted and different method of taxation involved in the present case.

Counsel for appellees contend that corporations not engaged in business remained, after 1929, subject to the old corporate excess tax. This may have been true, although the point has not been passed upon directly by the State Courts. In view of the adoption of the new and superseding system of corporate taxation, the attempt to levy taxes on the corporate excess was in practice abandoned and finally, in 1933, Section 4 of the Bank and Corporation Franchise Tax Act was amended so as to declare that corporations which were not doing business but which were subject to the provisions of Article XIII, Section 14 (d), should pay only the minimum annual fee of $25.00. The Supreme Court of the State has held that certain other amendments to Section 4, made at the same time, were merely declaratory and clarifying.

Union Oil Association v. *Johnson,* 212 Cal. (2nd), 727.

II.

THE SUBJECT OF THE TAX.

(Brief of Appellees, pages 13-21)

Counsel for appellees refer to fact that the Act purports to impose the tax "for the privilege of exercising * * * corporate franchises"; and they say that appellants had many privileges which *might* have been taxed by the State. But they do not dispute that what the State *actually did* in this case was to tax the doing of business This of course is the necessary effect of *Union Oil Associations* v. *Johnson,* 2 Cal. (2nd) 727; for under that case no corporation is taxable, no matter what privileges it enjoys or exercises, unless it *does business.*

It is because the tax is one on the doing of business that *Detroit International Bridge Co.* v. *Tax Appeal Board*, 287 U. S. 295, cited by appellees, does not apply. There the excise was based on the amount of paid up capital and surplus. The tax was upon the right to transact business, but the actual transaction of business was not a condition of the tax, as it is here. Whatever the similarity in statutory language, the two acts were interpreted and applied in an entirely different way. Obviously the *Detroit* case has no application to a tax on the actual doing of business.

The inapplicability of the *Detroit Bridge* case is clearly shown by the opinion of this court in *Anglo-Chilean Nitrate Sales Corporation* v. *Alabama*, 288 U. S. 218. There, as here, the State court had held that a mere holding company, not engaged in business, was not liable for the franchise tax, from which this court drew the inevitable inference that "the exaction is laid, not upon the authorization, right or privilege to do business in Alabama, but upon the actual doing of business." This being so, the *Detroit Bridge* case was held to be inapplicable, this court saying:

> "The Alabama statute is unlike that of Michigan examined here in Detroit International Bridge Co. v. Corporation Tax Appeal Board, 287 U. S. 295 * * *. There the tax on a domestic corporation was imposed for the mere right to transact business."

With reference to the suggestion (at pages 16 and 17 of Appellees' brief) that the tax is saved because it is imposed in a given year on the basis of receipts in the preceding year, it suffices to say that this must in practice be done if in any case where the tax is measured by annual receipts, whether gross or net. This Court has not hestitated to condemn taxes levied for a given year on the basis of the previous year's receipts, where the tax was in fact a burden on interstate commerce.

New Jersey Bell Telephone Co. v. *State Board of Taxes*, 280 U. S. 338.

Appellees argue that because the tax is not an unconstitutional tax on the income of tax-exempt securities (*Pacific Co.* v. *Johnson,* 285 U. S. 480), therefore it cannot be an unconstitutional burden on interstate and foreign commerce. This involves a *non sequitur.* In the case of tax-exempt bonds, the property itself, the bonds, are not taxable, either by direct property tax or by income tax; whereas a franchise tax, measured by their income, may be immune from attack. In the case of interstate and foreign commerce the situation is reversed. The property used is taxable, but the function, the doing of business, is not. Hence, the property used in commerce may be taxed, either by direct tax or by income tax; and the incidental effect upon the function does not vitiate. But where the function itself, the doing of business in interstate and foreign commerce, is taxed, whether expressly or by actual operation of the tax, the limit of permissible action is passed and the effort to tax is vain The cases involving tax-exempt securities do not, therefore, assist in the present problem.

Little need be added on the further discussion by appellees of the "subject of the tax". After in effect conceding that the tax is one on the doing of business (at page 11), counsel assume, without argument, that the tax is one on corporate privileges (at page 19). They do not discuss or attempt to explain the actual operation of the tax, as approved in this case by the State Supreme Court, under which the tax is levied first, on the income from intrastate business and then, in addition, on a certain part of interstate business, *i. e.,* that part which originates in California. Is it not clear, in view of this actual operation, what is the "subject of the tax"? Not only is it the doing of business, but it is the doing of specific business, to-wit: all intrastate business and a definite, designated part of interstate and foreign business. This being the factual situation, is it not futile to talk about imaginary subjects such as "corporate privileges"; for they are not made any the less imaginary by the use of statutory language which is

not followed by the Courts or taxing authorities in actual enforcement?

It must be remembered that the phrase "business done within this State" or its equivalent occurs again and again in the statute. Under section 4 the tax is imposed only on corporations "doing business within the limits of this State". The tax is paid, it is said, for the privilege of exercising franchises "within this State". Under section 10, if the entire business "is not done within this State, the tax shall be * * * measured by that portion thereof which is derived from business done within this State". Now this phrase would normally be interpreted as including only intrastate business, and excluding interstate business; so this Court held in *Pacific Express Co.* v. *Siebert*, 142 U. S. 339. But in this case the State Courts held that this phrase meant not only intrastate business, but also a part of interstate and foreign business. (See opinion of State Board of Equalization, R. p. 38; opinion of Supreme Court, R. pp. 66-67) The effect of the Supreme Court decision is that this statute must be considered as if it referred to and taxed, not "business done within this State", but instead "intrastate business done within this State and also all interstate and foregin business originating in this State". If these words had been written into the statute—and this, in effect, is what the Supreme Court did—the case would present no doubt or difficulty.

It is of interest, however, that counsel say (at page 19 of their brief) that a domestic corporation "engaged exclusively in interstate commerce would not be subject to the imposition." This statement is surprising, because it seems to be contrary to the implication in the Supreme Court opinion, which only felt driven to exclude *foreign* corporations engaged exclusively in interstate business. But if counsel's concession is correct, we have another proof that the tax is one on the doing of business and on that alone. If the tax were one on the right to be, or on the grant of corporate facilities by the State, then all domestic corpora-

tions (if they came within the statutory class of business corporations and did any business at all) would be subject to the tax. The mere power to act otherwise than in interstate commerce might subject them to the tax, as it did the bridge company in the *Detroit Bridge* case, 287 U. S. 295. But it is conceded that in spite of the domestic charter and the generality of powers granted, in spite of the business character of the corporation and the fact that business is actually done, nevertheless a corporation is not taxable if the business done is exclusively interstate or foreign. This concession precludes and falsifies any possible contention that the "subject of the tax" is the right "to be," or the corporate privileges granted by the State, or anything but the actual doing of business. The only real difference between the parties is whether the subject is the doing of intrastate business only, or the doing of intrastate business and also the doing of such interstate and foreign business as originates in California. We submit that the actual operation and effect of the statute, as interpreted and applied, is such as to compel an answer in favor of the latter alternative.

Something is said, at pages 20 and 21 of the brief of appellees, about the undesirability of curtailing unnecessarily the taxing power of the State. The simple answer to this suggestion is that our claim involves no such curtailment. If section 10 had been interpreted in the State Court as not calling for an apportionment to California of a segment of interstate business,—in other words, if the phrase "business done within this State," as used in this section, had been interpreted as not including a share of commerce with territories and foreign countries,—then the State taxing scheme would have been harmonious, adequate and valid. In view of the contrary interpretation of the State Court, a simple legislative amendment will restore the natural meaning of the words and leave unimpaired the legitimate taxing power of the State. Our contention does not involve

the crippling of the taxing power, but leaves it to operate in normal fashion upon the subjects over which the State has jurisdiction.

III.

THE MEASURE OF THE TAX.

(Brief of Appellees, page 21-23)

Under this head appellees cite:

(a) *United States Glue Co.* v. *Oak Creek,* 247 U. S. 321, and other cases holding that a general income tax is valid though some of the income is derived from transactions in interstate commerce. (See brief for Appellants, pages 40-44.)

(b) *Underwood Typewriter Co.* v. *Chamberlain,* 254 U. S. 113, dealing with taxes on the franchises of a unitary business where, although income from interstate commerce is one element in a complicated formula, it is not shown that the formula is applied so as to be an actual burden on interstate commerce. (See brief for Appellants, pages 44-46.)

(c) Cases holding that the Fourteenth Amendment does not forbid the taxation of the income or intangibles of individual residents or domestic corporations, even though the income in the one case, or the intangibles in the other, derive their value from transactions outside of the jurisdiction.

None of these matters has bearing on the instant problem. The measure of this tax is not the general income as such, much less the value of the corporate excess or intangibles. The measure here, as fixed by the State Court, is first of all the income from local business and secondly and in addition the income from such interstate and foreign business as originates within the State. This, and this alone, is the measure under consideration.

The statute under consideration provides that in cases where the entire business is not done within the State, the tax shall be measured by "that portion thereof which is derived from business done within this State" (Sec. 10 of the Act). The State Supreme Court holds that the quoted clause means "that portion thereof which is derived from intrastate business done within this state and from interstate and foreign commerce originating within this state." The legal effect of the decision is to substitute the latter clause for the one which appears now on the statute book. And the only question is whether the clause thus written into the statute does or does not state a permissible measure of taxation. We submit that it does not. Certainly the cases which appellees cite do not bear on the point.

IV.

DENIAL OF EQUAL PROTECTION OF LAWS.

(Brief of Appellees, pages 24-28)

The discussion of this subject by counsel calls only for this comment: that it wholly ignores the question of the identity of the subject of the tax. Either the tax is levied on interstate commerce or, as appellees claim (brief, p. 15), it is levied "for the privilege of engaging in intrastate commerce." Only on the latter theory can the tax be saved. On this theory we have a tax for the privilege of engaging in interstate commerce, which is measured

> (a) as to some corporations, by the income from such intrastate commerce;
>
> (b) as to other corporations, including appellants, by the income from such intrastate commerce plus the income from such interstate and foreign commerce as originates in California.

The discrimination and its arbitrary character are patent. No possible justification therefor is suggested.

Reference has been made to the further discrimination in favor of the foreign corporations, competitors of appellants, who are exclusively engaged in interstate or foreign commerce and who, under the decision of the State Supreme Court, need pay no tax. It is now said that this discrimination is allowed in order that the Federal Constitution may be obeyed. (brief for Appellees, p. 26) But it is said that no constitutional restriction protects the income of domestic corporations (brief of appellees, p. 23), notwithstanding which, according to appellees, domestic corporations which are exclusively engaged in interstate commerce are not subject to the act. (brief for Appellees, p. 19) No excuse is given for the resulting discrimination between appellants and domestic corporations who are their competitors and who do the same amount of interstate business but no local business. The appellants must pay the tax, not only on their local business, but also on all interstate and foreign business originating in California. The competitors pay nothing.

One further aspect of the denial of the equal protection of the laws is brought out by the brief of appellees. They state (brief, p. 19) that domestic corporations engaged exclusively in interstate commerce are not subject to the tax. This statement, made by the State Attorney General, must be assumed to represent accurately the actual administration of the taxing statute. Accepting it, we have a case where, as between two domestic corporations similarly situated, the tax of one is measured, perhaps as to 99 per cent thereof, by its income from interstate business, and the other, doing the same amount of interstate business is not taxed at all. To such a situation the decision in *Royster Guano Co.* v. *Virginia*, 253 U. S. 412, clearly and directly applies.

V.

DUE PROCESS.

(Brief of Appellees, pages 28-29)

Our contention that due process has been denied is based upon the arbitrary character of the exaction. This question is not touched by the reply brief.

Respectfully submitted,

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